

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LAKE CITY WATER)
DISTRICT FOR AN ADJUSTMENT OF RATES) CASE NO. 9612
PURSUANT TO THE ALTERNATIVE)
PROCEDURE FOR SMALL UTILITIES)

O R D E R

On June 23, 1986, Lake City Water District ("Lake City") filed an application with the Commission to increase its rates pursuant to 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities ("ARF"). There were no intervenors in this matter and all information requested by the Commission has been submitted. Lake City requested rates which would produce an increase in annual revenues of \$10,432 or 30.8 percent.

A hearing was not requested in this matter and in accordance with the provisions of the ARF no hearing was conducted. The decision of the Commission is based on information contained in the application, annual reports and responses to written data requests. Based on the findings herein the Commission has granted an increase in revenues of \$7,928 annually or 23.4 percent.

TEST PERIOD

Lake City proposed and the Commission has accepted the 12-month period ended December 31, 1985, as the test period in this matter.

REVENUES AND EXPENSES

Lake City reported a net loss for the test year of \$2,618 and proposed no pro forma adjustments in its original application. In response to a data request Lake City proposed three adjustments to operating expenses and a list of proposed plant additions and improvements it intends to finance with the additional revenues requested herein. The Commission has reviewed Lake City's proposals and has made the following adjustments to the test period operations:

Tax Collection

During the test year Lake City collected \$1,015 for the local taxing authority through a 3 percent tax on its revenues. Lake City reported these collections as Revenue from Water Sales and reported the payout of these amounts as Taxes Other than Income Taxes. This is improper both for accounting and rate-making purposes. This is a tax -- a tax imposed on the customers of Lake City. Lake City merely acts as a collection agent for the taxing authority. This tax is neither a revenue nor expense for Lake City and should not be recorded as such. Accordingly, the Commission has reduced both operating revenues and operating expenses by \$1,015 to reflect this change.

Operating Expenses

Lake City proposed adjustments totalling \$827 to reflect increases in wages, bookkeeping expenses and insurance premiums. The Commission has reviewed these adjustments in relation to Lake City's test year operating expenses and finds them to be

acceptable for rate-making purposes and has increased operating expenses accordingly.

Plant Additions and Improvements

In its response to the written data request Lake City presented a list of expenditures it intended to finance with the increased revenues requested herein. The proposed expenditures, which total \$8,674, include a new roof for the treatment plant, flow meter, high service water pump, electronic typewriter and desk-top calculator.

Typically, the Commission does not include prospective expenditures in the determination of revenue requirements unless they are of such magnitude as to require outside financing. Such items are not properly includible on the income statement and cannot be recovered through rates until the expenditure has been made and the asset is being depreciated. However, on a cash flow basis the Commission will consider Lake City's historical levels of plant additions along with Lake City's other cash requirements.

Depreciation Expense

It is the practice of the Commission to compute depreciation expense for rate-making purposes on the basis of the original cost of plant in service less the amount of contributions in aid of construction, since a utility should not be allowed recovery of that portion of plant which has been provided at no cost to the utility. No evidence was provided by Lake City which would change the Commission's position on this issue. Therefore, the

Commission has made an adjustment to reduce Lake City's depreciation expense by \$4,623 to \$1,728 for rate-making purposes.¹

After all adjustments, Lake City's adjusted test period operations appear as follows:

	<u>Test Year Actual</u>	<u>Commission Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenues	\$38,227	\$<1,015>	\$37,212
Operating Expense	38,461	<4,811>	33,650
Operating Income	<u>\$ <234></u>	<u>\$ 3,796</u>	<u>\$ 3,562</u>

REVENUE REQUIREMENTS

In addition to the adjusted operating expenses of \$33,650 shown in the preceding table, Lake City has an average annual debt service requirement of \$6,901. Furthermore, for the past 5 years Lake City has made additions to its utility plant in service at an average rate of \$5,700 annually. The Commission has considered these factors in making its determination of Lake City's revenue requirements and has made its decision as follows:

¹ Test Year Depreciation Expense	\$ 6,351
Test Year-End Plant In Service	\$255,708
Composite Depreciation Rate	2.484%
 Plant In Service	 \$255,708
Less:	
Contributions in Aid of Construction	186,153
Non-Contributed Utility Plant	\$ 69,555
X Composite Depreciation Rate	<u>.02484</u>
Depreciation on Non-Contributed Utility Plant	<u>\$ 1,728</u>

A return on rate base would not generate adequate revenues due to the large percentage of contributed property Lake City has. Likewise, due to Lake City's relatively small debt service requirement a debt service coverage would produce only a minimal increase in revenues. The Commission is of the opinion that a modified operating ratio will best serve the needs of Lake City and has calculated the revenue increase accordingly.

Applying the standard operating ratio of .88 results in a revenue requirement of \$38,239 to cover Lake City's adjusted operating expenses.² Typically, this amount is increased by the utility's interest expense on long-term debt to arrive at the total revenue requirement. However, Lake City is in the twenty-third year of a 30-year repayment schedule and its interest expense over the next 7 years will account for less than 20 percent of its total debt service requirement over that 7-year period. Therefore, to ignore the principal portion of Lake City's annual debt service would mean ignoring the reality of an annual cash outflow of \$5,000 or greater for the remainder of the pay back period. Due to these circumstances, in this case the Commission finds it appropriate to add the full debt service requirement, rather than just the interest, in calculating Lake City's revenue requirement. Such calculation results in an annual revenue requirement of \$45,140 which is an increase of \$7,928 over

² \$33,650 • .88 = \$38,239

Lake City's adjusted annual revenue.³ This increase results in a positive cash flow of \$6,317 after debt service payments.⁴

The change in Lake City's revenues can be summarized as follows:

	<u>Before Increase</u>	<u>After Increase</u>
Water Sales	\$33,830	\$41,758
Penalties	587	587
Miscellaneous	803	803
Interest Income	<u>1,992</u>	<u>1,992</u>
Total	<u>\$37,212</u>	<u>\$45,140</u>

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Lake City would produce revenues in excess of the revenues found reasonable herein and should be denied pursuant to KRS 278.030.

2. The rates in Appendix A are fair, just and reasonable rates for Lake City and should produce annual revenues from water sales of \$41,758 which along with Lake City's other sources of revenue should produce gross annual revenues of \$45,140.

³ $\$33,650 \div .88 = \$38,239 + \$6,901 \text{ (Debt Service)} = \$45,140$

⁴

Total Revenues	\$45,140
Less: Operating Expenses	33,650
Debt Service Payments	6,901
Plus: Non-Cash Expenses	
Depreciation	<u>1,728</u>
Net Cash Flow	<u>\$ 6,317</u>

IT IS THEREFORE ORDERED that:

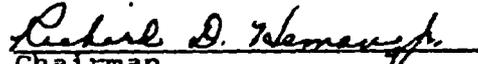
1. The rates in Appendix A be and they hereby are approved for service rendered by Lake City on and after the date of this Order.

2. The rates proposed by Lake City be and they hereby are denied.

3. Within 30 days of the date of this Order Lake City shall file with this Commission its revised tariffs setting out the rates authorized herein.

Done at Frankfort, Kentucky, this 17th day of September, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9612 DATED 9/17/86

The following rates and charges are prescribed for the customers in the area served by Lake City Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RATES: Monthly

First 2,000 Gallons	\$6.45 Minimum Bill
Next 8,000 Gallons	1.25 Per 1,000 Gallons
Next 10,000 Gallons	1.10 Per 1,000 Gallons
Over 20,000 Gallons	1.00 Per 1,000 Gallons